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TAGS: EFIN ECON EAID ETRD VM BTA FINREF SOE
SUBJECT: VIETNAM'S BANKING SECTOR

REF: 03 HCMC 1157

SENSITIVE BUT UNCLASSIFIED - PLEASE HANDLE ACCORDINGLY.

¶1. (SBU) SUMMARY: Vietnam's banking sector is presently characterized by a few dominant state-owned commercial banks (SOCBs), a number of comparatively small joint stock banks (JSBs), and some foreign banks. In recent years, the GVN has undertaken a number of reforms, with the goals of ensuring the banking system's stability, expanding services, and rationalizing domestic resource allocation by ensuring that they are dedicated to commercially viable activities. The reform program focuses on four main areas - the restructuring and commercialization of SOCBs, restructuring of JSBs, meeting Vietnam's international commitments, and improving the regulatory framework and enhancing transparency. Unfortunately, many areas of concern remain largely unresolved. Progress on restructuring the SOCBs is sluggish. Classification of non-performing loans (NPLs) has improved, but deficiencies persist in both the accounting and strategy. Furthermore, the slow pace of SOE reform may negate efforts to address this issue. Foreign banks continue to compete on an unequal footing with Vietnamese banks. Although directed lending has been largely removed from the SOCBs, it continues to take place. In addition, it is now concentrated in institutions outside the formal banking system, thus eliminating the ability to account for total lending in Vietnam. Finally, despite efforts to strengthen the SBV, it remains weak and fragmented. END SUMMARY.

STATE-OWNED COMMERCIAL BANKS

¶2. (U) Vietnam's state-owned commercial banks (SOCBs) dominate its financial sector, with the four largest SOCBs representing around 70 percent of the system's total assets. The Ministry of Finance (MOF) "owns" the SOCBs. The GVN has stated that it intends to preserve the domination of SOCBs by developing them into commercially-oriented financial intermediaries. Towards this end, it has begun implementing a restructuring plan for the four largest SOCBs. In June 2003, SBV announced its plan to equitize the remaining SOCB, the Mekong Housing Bank, between 2006 and 2010. In 2005, a plan for equitization is to be undertaken. The preparations are to include an independent financial and portfolio audit based on IAS, a diagnostic assessment of its operations, and a review of its external policy and legislative environment.

¶3. (U) Over the past year, a number of developments have increased the number of products and services offered to clients of SOCBs and raised the share of their credit allocated to the private sector. (Note: Despite this increase, the private sector continues to complain about lacking access to capital, and SOCBs remain extremely cautious about lending to it, and do so only on a highly-collateralized basis. End Note.) SOCBs still view state-owned enterprises, especially large state-owned corporations, as their core customers and give them priority access to credit. This credit is extended mostly on an unsecured basis, relying on the government's support and implied backing given to those companies. Because financial health and credit risk are not adequately assessed, credit margins are not properly priced, which in turn may narrow the banks profitability. Even though their application appears irregular, SOCBs have drafted credit manuals. Due to this weak credit risk analysis and unofficial ceilings, most SOCBs are encountering difficulties implementing the recent interest rate liberalization that allows banks to freely determine the rates that they charge.

¶4. (U) Vietnam chose to retain Vietnam Accounting Standards (VAS) and not adopt International Accounting Standards (IAS). However, it has improved VAS, causing loan portfolios to be reclassified based on rules that are close international norms. (Note: Previously, VAS simply counted the amount of the missed loan payment. Now, when a payment is missed, banks must follow international practice and

count the entire loan amount as non-performing. End Note.) The four SOCBs also completed donor-funded IAS audits for 2000 and 2001 and improved loan loss provisioning. They began launching a computerized banking system pilot program that will allow customers to withdraw money at any branch instead of just the one where they opened their account.

¶5. (SBU) Although the GVN and SOCBs made some progress on resolving NPLs and improving capital adequacy, problems especially persist in these areas. The SBV alleges that the SOCBs have resolved around 30 percent of their stock of NPLs (identified as of December 2000). However, the actual percentage of NPLs remains difficult to estimate, because many banks are now rescheduling and restructuring loans in order to ensure that they meet their NPL targets. Even though the SBV has declined to estimate the amount of NPLs, simply stating that restructuring has reduced the amount, international experts estimate that NPLs account for between 15 and 25 percent of Vietnam's loan portfolio. Difficulties in this area also remain, because many loans lack collateral, especially those to state-owned enterprises (SOEs). Therefore, the GVN is discussing a mechanism that would trade the debts of SOEs scheduled for equitization. Still, delays in SOE reform have made it difficult for SOCBs to meet their resolution targets (see septel on SOE reform).

¶6. (SBU) After declaring that it would undertake a conditional recapitalization based on banks' reform efforts, the GVN found the banks' restructuring plans too dated and vague to be practically used for targeting recapitalization. Therefore, the past three phases of recapitalization valued at 7.75 trillion VND (approximately a half billion USD) have not occurred in a transparent manner, do not appear to have dealt with underlying problems in the banking system, and were based on separate targets from the Ministry of Finance and SBV. The GVN has simply injected more capital into all SOCBs without requiring that they address systemic problems. If capital structures are not changed, such continuing large expenditures will be of little value for the development of the banks and may dilute incentives for reform. (Note: The World Bank estimates that the actual recapitalization needs of SOCBs may exceed five times that already provided if current NPL estimates are accurate. End Note.)

¶7. (U) Several additional operational changes are envisaged in the current restructuring, which should encourage SOCBs to operate in a more market-oriented manner with management held accountable for operations and results. The GVN has agreed to the importance of separating the GVN's ownership role of the SOCBs from day-to-day activities. A clearer separation of the roles and responsibilities of the Board of Directors and the bank management is also to be developed in the near future. While the Board will be responsible for setting and ensuring compliance with the overall credit policies of the bank, the management will only act as implementers. Furthermore, SOCBs will establish separate credit and risk management teams. To assist with these changes, a number of donors are funding "twinning" projects that bring together respected international banks and SOCBs. Although hope remains high that these programs will help the SOCBs, the lack of human resource capacity may prevent them from achieving their ambitious goals.

JOINT STOCK BANKS

¶8. (U) In Vietnam, joint stock banks (JSBs) have in many ways taken on the role of local, "private" banks. (Note: Every JSB still has some level of state interest and indirect SBV management. End Note.) Following a recent series of mergers and liquidations, thirty-six JSBs now operate in Vietnam and account for approximately 12 percent of the lending. Primarily geared toward small and medium-sized enterprises and private companies, JSBs play an important role in providing credit and banking services to the private sector. In addition, they tend to be more dynamic and customer oriented than SOCBs. However, they lack extensive networks and expertise in international trade and complex transactions.

¶9. (U) Although parts of this sector have posted strong growth and performance, approximately one third are still encountering problems in these areas. The SBV continues to strictly monitor these weaker ones, encouraging them to merge and revoking licenses when necessary. In addition, most JSBs have undergone restructuring to increase their viability. SBV has provided capacity training for managers in order to strengthen personnel management, and like the SOCBs, the GVN has increased their charter capital. However, some regulatory discrimination between JSBs and SOCBs remain. Unlike SOCBs, JSBs are not permitted to open an extensive branch network. (See reftel for more information about a successful JSB.)

FOREIGN BANKS

¶10. (U) Although Vietnam's banking services have evolved in the past few years, the "rules of the game" continue to vary significantly for different players, with foreign banks experiencing the greatest limitation on their operations. Among other issues, SBV still tightly controls the granting of banking licenses. At present, 27 branches and 42 representative offices of foreign banks operate in Vietnam, accounting for approximately 24 percent of the banking system's chartered capital, 15 percent of lending, and around 8.5 percent of the sector's assets. Leading foreign banks with branches in Vietnam include Citibank, JP Morgan Chase, HSBC, Deutsche Bank, Standard Chartered, and ANZ, and Wachovia recently opened a representative office. In addition, there are four joint venture banks in Vietnam, which account for around 3 percent of lending.

¶11. (U) With the 2001 U.S.-Vietnam Bilateral Trade Agreement (BTA), Vietnam made a number of commitments in the field of financial services. The GVN has generally sought to address these obligations through a non-specific assurance that BTA obligations take precedence over domestic legislation in cases of conflict. Specifically, the SBV has stated that BTA provisions shall become effective immediately when due regardless of the status of domestic legislation. It plans to address this commitment by issuing individual regulations each time an obligation comes due rather than issuing a "blanket" decree.

¶12. (U) Among other commitments, the GVN agreed to increase the ratio of deposits in Vietnamese Dong (VND) from an original level of 25 percent of the branch's legal capital under the terms of the BTA. This ratio is to increase annually for U.S. banks until full national treatment is applied in year eight (starting December 2008). U.S. banks are currently allowed to accept Dong deposits at a level of 250 percent of their legal capital. In addition, in response to significant lobbying from non-U.S. foreign banks, the SBV decided in September to increase their ratio to fifty percent of their legal capital.

¶13. (SBU) A number of new products were introduced in a limited number of foreign banks and SOCBs in 2003. The SBV is now allowing a few banks to offer currency options on a trial basis. It also permitted some, including Citibank, to provide interest rate swaps on a provisional basis. In general, foreign banks find themselves at a disadvantage when it comes to introducing new products since the SBV must approve each one. In addition, foreign banks are limited in their branch networks, restricted on accepting Dong deposits, prevented from taking initial mortgage interest in land use rights, and not allowed to issue credit cards. (Note: Under the terms of the BTA, U.S. banks will be allowed to take mortgage interest starting in December 2004 and issue credit cards in December 2009. End note.) They, therefore, tend to provide only wholesale banking services and concentrate on multinational corporations and foreign invested enterprises. This reliance makes their business vulnerable to the flow of foreign direct investment.

POLICY LENDING INSTITUTIONS

¶14. (U) One of Vietnam's major reforms in recent years has been to move "policy lending" out of SOCBs by creating the Development Assistance Fund (DAF) and the Bank for Social Policy (VBSP). The DAF is a specialized institution aimed at conducting policy-based lending to large scale, medium- and long-term projects. Although the GVN has committed to revising the DAF's governing framework in 2004, its purpose will remain unchanged. The VBSP is designed to provide preferential lending to targeted poor and remote households. However, because it is both a deposit taking and a policy lending institution, inherent risks exist for those deciding to invest in the VBSP.

¶15. (SBU) These extra-budgetary institutions were created to shift the problems associated with policy lending from the financial sector. Unfortunately, they could create a significant burden on the budget depending upon the quality of the lending and whether final borrowers can service their debts. Given the DAF's lack of transparency and expertise in credit and risk management, this possibility appears highly likely. This risk is further exacerbated by the fact that these institutions appear to be the GVN's current quasi-fiscal method to maintain SOEs.

THE STATE BANK OF VIETNAM

¶16. (U) The State Bank of Vietnam acts as the supervisory and regulatory body for the banking sector. The SBV, in cooperation with a number of donors and international financial institutions, is working to strengthen its internal processes and enhance the quality of inspection. In the past, it simply focused on ensuring that financial institutions complied with laws and regulations whereas now,

it is attempting to analyze asset quality and risk. In addition, it is trying to strengthen its independence and supervision of the banks within its jurisdiction. Unlike in the U.S., though, the SBV is not an independent body, and it continues to operate under government guidance.

¶17. (U) In addition to its role as supervisor/regulator, SBV also acts as the SOCBs' shareholder even though the SOCBs are officially "owned" by the Ministry of Finance. The SBV is tasked with acting as the state body managing the banking system. To that end, the SBV has permanent representation on Supervisory Boards and appears, through various appointments, approval, and licensing processes, to be involved in such daily activities in SOCBs that are essentially powers to be exercised by the owner. This dual role jeopardizes the SBV's independence in supervising SOCBs, distorts the playing field for other institutions, and makes business decisions difficult to undertake.

¶18. (U) Organizationally, SBV possesses a heavy, fragmented structure, which can lead to issues falling between the cracks, duplication of work, and slow internal flow of information. Furthermore, the reporting lines from financial institutions to various departments are unclear, resulting in inefficiencies, overlapping information, and the potential that some data is not reviewed. Finally, SBV's regional structure with 61 branch offices limits the central government's ability to direct overall operations. Experts have recommended that the GVN substantially reduce this number and clarify the reporting lines. An expert evaluation of nine of the Basel Core Principles identified a number of weaknesses, including a lack of consistency, transparency and accountability in the banking system and in the bank supervision process.

¶19. (SBU) COMMENT: Unfortunately, most of the banking system reforms that Vietnam has undertaken in recent years appear to be mere "window dressing" rather than an effort to address systemically the system's weaknesses. The main areas of concern - SOCBs, directed lending, non-performing loans (NPLs), a level playing field, and State Bank of Vietnam (SBV) supervision - remain largely unresolved. This situation has created significant risks to the system, which are exacerbated by the high current rate of credit growth to the economy. (Note: Estimated at around 30 percent for 2003, this growth rate concerns the international financial institutions, as well international experts. End note.)

¶20. (SBU) COMMENT CONT'D: Still, even though it is occurring slowly, the policy environment continues to improve, and donor technical assistance, especially the USAID-funded Support for Trade AcceleRation (STAR) project, is raising the GVN's capacity to implement reforms. Vietnam's senior leaders accept that reform in this area must take place if future economic growth goals are to be achieved. However, the emphasis appears to be on "managing" the changes and reform necessitated by international commitments and domestic economic conditions rather than pushing forward aggressively. While fears about risks and challenges remain, fairly solid agreement exists within the GVN about the need to bring Vietnam's economy into conformity with international standards, meet its BTA obligations, and accede to the WTO. Vietnam's financial sector and broader economic reform commitments, especially those in the BTA, have and will shape the discussion regarding banking reform and ensure that it continues into the future. BURGHARDT